
How Entrepreneurs Craft Strategies That Work

by Amar Bhide



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Entrepreneurs adopt the approaches that work – and they're quick,

How Entrepreneurs Craft

by Amar Bhide

However popular it may be in the corporate world, a comprehensive analytical approach to planning doesn't suit most start-ups. Entrepreneurs typically lack the time and money to interview a representative cross section of potential customers, let alone analyze substitutes, reconstruct competitors' cost structures, or project alternative technology scenarios. In fact, too much analysis can be

By the time an opportunity is investigated fully, it may no longer exist.

harmful; by the time an opportunity is investigated fully, it may no longer exist. A city map and restaurant guide on a CD may be a winner in January but worthless if delayed until December.

Interviews with the founders of 100 companies on the 1989 *Inc. "500"* list of the fastest growing private companies in the United States and recent research on more than 100 other thriving ventures by my MBA students suggest that many successful entrepreneurs spend little time researching and analyzing. (See the insert, "Does Planning Pay?") And those who do often have to scrap their strategies and start over. Furthermore, a 1990 National Federation of Independent Business study of 2,994 start-

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ups showed that founders who spent a long time in study, reflection, and planning were no more likely to survive their first three years than people who seized opportunities without planning. In fact, many corporations that revere comprehensive analysis develop a refined incapacity for seizing opportunities. Analysis can delay entry until it's too late or kill ideas by identifying numerous problems.

Yet all ventures merit some analysis and planning. Appearances to the contrary, successful entrepreneurs don't take risks blindly. Rather, they use a quick, cheap approach that represents a middle ground between planning paralysis and no planning at all. They don't expect perfection – even the most astute entrepreneurs have their share of false starts. Compared to typical corporate practice, however, the entrepreneurial approach is more economical and timely.

What are the critical elements of winning entrepreneurial approaches? Our evidence suggests three general guidelines for aspiring founders:

1. Screen opportunities quickly to weed out unpromising ventures.
2. Analyze ideas parsimoniously. Focus on a few important issues.
3. Integrate action and analysis. Don't wait for all the answers, and be ready to change course.

Screening Out Losers

Individuals who seek entrepreneurial opportunities usually generate lots of ideas. Quickly discarding those that have low potential frees aspirants to

cheap, and timely.

Strategies That Work

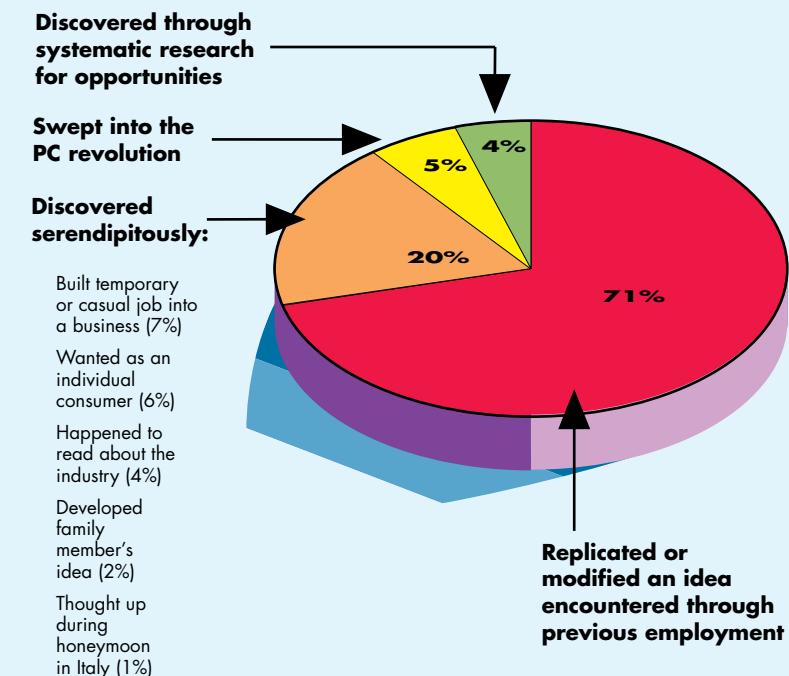
concentrate on the few ideas that merit refinement and study.

Screening out unpromising ventures requires judgment and reflection, not new data. The entrepreneur should already be familiar with the facts needed to determine whether an idea has *prima facie* merit. Our evidence suggests that new ventures are usually started to solve problems the founders have grappled with personally as customers or employees. (See the diagram "Where Do Entrepreneurs Get Their Ideas?") Companies like Federal Express, which grew out of a paper its founder wrote in college, are rare.

Profitable survival requires an edge derived from some combination of a creative idea and a superior capacity for execution. (See the diagram "Tipping the Competitive Balance.") The entrepreneur's creativity may involve an innovative product or a process that changes the existing order. Or the entrepreneur may have a unique insight about the course or consequence of an external change: the California gold rush, for example, made paupers of the thousands caught in the frenzy, but Levi Strauss started a company – and a legend – by recognizing the opportunity to supply rugged canvas and later denim trousers to prospectors.

But entrepreneurs cannot rely on just inventing new products or anticipating a trend. They must also execute well, especially if their concepts can be copied easily. For example, if an innovation cannot be patented or kept secret, entrepreneurs must acquire and manage the resources needed to build a brand name or other barrier that will deter imitators. Superior execution can also compensate for a

Where Do Entrepreneurs Get Their Ideas?



Source: 100 founders of the 1989 Inc. "500" fastest growing private companies.

Does Planning Pay?

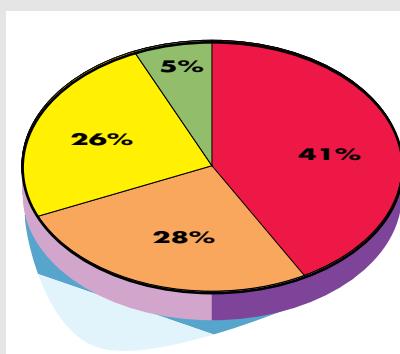
Interviews with the founders of 100 companies on the 1989 *Inc. "500"* list of the fastest growing companies in the United States revealed that entrepreneurs spent little effort on their initial business plan:

- 41% had no business plan at all.
- 26% had just a rudimentary, back-of-the-envelope type of plan.
- 5% worked up financial projections for investors.
- 28% wrote up a full-blown plan.

Many entrepreneurs, the interviews suggested, don't bother with well-formulated plans for good reasons. They thrive in rapidly changing industries and niches that tend to deter established companies. And under these fluid conditions, an ability to roll with the punches is much more important than careful planning.

The experiences of two *Inc. "500"* companies, Attronica Computers and Bohdan Associates, illustrate the limitations of planning in entrepreneurial ventures. Carol Sosdian and Atul Tucker, who had worked together in a large corporation, started Attronica in 1983 to retail personal computers in Washington, D.C. Carol recalls that Atul "wrote a one-paragraph business plan and brought it to me, and I turned it into a real business plan. It took about one month, and then we bantered back and forth over the next three months. We got to where we thought it might work, and then we showed it to some friends. It passed the 'friends test.'"

Heartened, Carol and Atul conducted almost two years of market research, which led them to purchase a Byte franchise for \$150,000. Soon after they opened their first store, however, Byte folded. They then signed on as a franchisee of World of Computers, which also folded; and in 1985, Attronica began to operate as an independent, direct dealer for AT&T's computers. This partnership clicked, and Attronica soon became one of AT&T's best dealers. Attronica also



Only 28% of the entrepreneurs wrote up a full-blown plan.

changed its customer focus from people off the street to corporate and government clients. They found large clients much more profitable because they valued Attronica's technical expertise and service.

Peter Zacharkiw founded Bohdan Associates in a Washington, D.C., suburb in the same year that Atul and Carol launched Attronica. Peter did not conduct any research, however. He was employed by Bechtel and invested in tax shelters on the side. He bought a computer for his tax shelter calculations, expecting to deduct the cost of the machine from his income. When Peter discovered that he was overdeducted for the year, he placed an ad in the *Washington Post* to sell his computer. He got over 50 responses and sold his machine for a profit. Peter figured that if he had had 50 machines, he could have sold them all and decided to begin selling computers from his home. "At first, I just wanted to earn a little extra Christmas money," he recalls. "My wife put systems together during the day, and I delivered them at night. We grew to \$300,000 per month, and I was still working full-time. I made more than I would have made the entire year at Bechtel."

Like Attronica, Bohdan evolved into serving corporate clients. "First, we sold to individuals responding to ads. But these people were working for companies, and they would tell their purchasing agents, 'Hey, I know where you can get these.' It was an all-referral business. I gave better service than anyone else. I knew the machines technically better than anyone else. I would deliver them, install them, and spend time teaching buyers how to use them." In 1985, after customers started asking for Compaq machines, Bohdan became a Compaq dealer, and the business really took off. "We're very reactive, not proactive," Peter observes. "Business comes to us, and we react. I've never had a business plan."

me-too concept in emerging or rapidly growing industries where doing it quickly and doing it right are more important than brilliant strategy.

Ventures that obviously lack a creative concept or any special capacity to execute—the ex-consultant's scheme to exploit grandmother's cookie recipe, for instance—can be discarded without much thought. In other cases, entrepreneurs must reflect on the adequacy of their ideas and their capacities to execute them.

Successful start-ups don't need an edge on every front. The creativity of successful entrepreneurs varies considerably. Some implement a radical idea, some modify, and some show no originality. Capacity for execution also varies among entrepreneurs. Selling an industrial niche product doesn't call for the charisma that's required to pitch trinkets through infomercials. Our evidence suggests that there is no ideal entrepreneurial profile either: successful founders can be gregarious or taciturn,

analytical or intuitive, good or terrible with details, risk averse or thrill seeking. They can be delegators or control freaks, pillars of the community or outsiders. In assessing the viability of a potential venture, therefore, each aspiring entrepreneur should consider three interacting factors:

1. Objectives of the Venture. Is the entrepreneur's goal to build a large, enduring enterprise, carve out a niche, or merely turn a quick profit? Ambitious goals require great creativity. Building a large enterprise quickly, either by seizing a significant share of an existing market or by creating a large new market, usually calls for a revolutionary idea. Launching Home Depot, for example, called for a new retailing concept of immense proportions; opening a traditional hardware store does not. Revolutionary enterprises usually require new processes or manufacturing techniques; competitive markets rarely fail to provide valuable products or services unless providing them involves serious technological problems.

Requirements for execution are also stiff. Big ideas often necessitate big money and strong organizations. Successful entrepreneurs, therefore, require an evangelical ability to attract, retain, and balance the interests of investors, customers, employees, and suppliers for a seemingly outlandish vision, as well as the organizational and leadership skills to build a large, complex company quickly. In addition, the entrepreneur may require considerable technical know-how in deal making, strategic

planning, managing overhead, and other business skills. The revolutionary entrepreneur, in other words, would appear to require almost superhuman qualities: ordinary mortals need not apply.

Consider Federal Express founder Fred Smith. His creativity lay in recognizing that customers would pay a significant premium for reliable overnight delivery and in figuring out a way to provide the service for them. Smith ruled out using existing commercial flights, whose schedules were

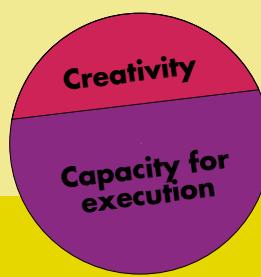
**There is no ideal profile.
Entrepreneurs can be gregarious
or taciturn, analytical or
intuitive, cautious or daring.**

designed to serve passenger traffic. Instead, he had the audacious idea of acquiring a dedicated fleet of jets and shipping all packages through a central hub that was located in Memphis.

As with most big ideas, the concept was difficult to execute. Smith, 28 years old at the time, had to raise \$91 million in venture funding. The jets, the hub, operations in 25 states, and several hundred trained employees had to be in place before the company could open for business. And Smith needed great fortitude and skill to prevent the fledgling enterprise from going under: Federal Express lost over \$40 million in its first three years. Some in-

Tipping the Competitive Balance

**Doing the right thing:
an innovative or
farsighted concept**



**Doing things right:
exceptional ability
for execution**

Competition

**Potential competition:
direct rivals, new entrants,
substitutes, buyers, suppliers,
or other sources**

vestors tried to remove Smith, and creditors tried to seize assets. Yet Smith somehow preserved morale and mollified investors and lenders while the company expanded its operations and launched national advertising and direct-mail campaigns to build market share.

In contrast, ventures that seek to capture a market niche, not transform or create an industry, don't need extraordinary ideas. Some ingenuity is necessary to design a product that will draw customers away from mainstream offerings and overcome the cost penalty of serving a small market. But features that are too novel can be a hindrance; a niche market will rarely justify the investment required to educate customers and distributors about the benefits of a radically new product. Similarly, a niche venture cannot support too much production or distribution innovation; unlike Federal Express, the Cape Cod Potato Chip Company, for example, must work within the limits of its distributors and truckers.

And since niche markets cannot support much investment or overhead, entrepreneurs do not need the revolutionary's ability to raise capital and build large organizations. Rather, the entrepreneur must be able to secure others' resources on favorable terms and make do with less, building brand awareness through guerrilla marketing and word of mouth instead of national advertising, for example.

Jay Boberg and Miles Copeland, who launched International Record Syndicate (IRS) in 1979, used a niche strategy, my students Elisabeth Bentel and Victoria Hackett found, to create one of the most successful new music labels in North America. Lacking the funds or a great innovation to compete against the major labels, Boberg and Miles promoted "alternative" music—undiscovered British groups like the Buzzcocks and Skafish—which the major labels were ignoring because their potential sales were too small. And IRS used low-cost, alternative marketing methods to promote their alternative music. At the time, the major record labels had not yet realized that music videos on televi-

Entrepreneurs at International Record Syndicate built customer awareness through guerrilla marketing on MTV Music Television.



sion could be used effectively to promote their products. Boberg, however, jumped at the opportunity to produce a rock show, "The Cutting Edge," for MTV. The show proved to be a hit with fans and an effective promotional tool for IRS. Before "The Cutting Edge," Boberg had to plead with radio stations to play his songs. Afterward, the MTV audience demanded that disc jockeys play the songs they had heard on the show.

2. Leverage Provided by External Change. Exploiting opportunities in a new or changing industry is generally easier than making waves in a mature industry. Enormous creativity, experience, and contacts are needed to take business away from competitors in a mature industry, where market forces have long shaken out weak technologies, strategies, and organizations.

But new markets are different. There start-ups often face rough-around-the-edges rivals, customers who tolerate inexperienced vendors and imperfect products, and opportunities to profit from shortages. Small insights and marginal innovations, a little skill or expertise (in the

land of the blind, the one-eyed person is king), and the willingness to act quickly can go a long way. In fact, with great external uncertainty, customers and investors may be hesitant to back a radical product and technology until the environment settles down. Strategic choices in a new industry are often very limited; entrepreneurs have to adhere to the emerging standards for product features, components, or distribution channels.

The leverage provided by external change is illustrated by the success of numerous start-ups in hardware, software, training, retailing, and systems integration that emerged from the personal computer revolution of the 1980s. Installing or fixing a computer system is probably easier than repairing a car; but because people with the initiative or foresight to acquire the skill were scarce, entrepreneurs like Bohdan's Peter Zacharkiw built successful dealerships by providing what customers saw as exceptional service (see the insert). As one Midwestern

dealer told me, "We have a joke slogan around here: We aren't as incompetent as our competitors!"

Bill Gates turned Microsoft into a multibillion-dollar company without a breakthrough product by showing up in the industry early and capitalizing on the opportunities that came his way. Gates, then 19, and his partner Paul Allen, 21, launched Microsoft in 1975 to sell software they had created. By 1979, Microsoft had grown to 25 employees and \$2.5 million in sales. Then in November 1980, IBM

External changes can provide great leverage for creative and nimble entrepreneurs.

chose Microsoft to provide an operating system for its personal computer. Microsoft thereupon bought an operating system from Seattle Computer Products, which it modified into the now ubiquitous MS-DOS. The IBM name and the huge success of the 1-2-3 spreadsheet, which only ran on DOS computers, soon helped make Microsoft the dominant supplier of operating systems.

Microsoft won the operating system battle without clockwork execution and amidst considerable organizational turmoil. According to author Scott Lewis, during the early 1980s, "The firm was doubling in size every year and had not yet adapted to being a large company. Gates, whose volatile temperament was well-known in the computer industry, had exacerbated Microsoft's chaos by abruptly changing product specifications and moving developers around."¹

External changes, such as collapses in the price of real estate or energy, also create opportunities for entrepreneurs who speculate in out-of-favor assets. Sam Zell, the self-described "grave dancer," and his now deceased partner, Robert Lurie, built a multibillion-dollar real estate and industrial empire through such opportunities. Their first big success followed the collapse of the real estate investment trusts in the early 1970s. Later they picked up millions of square feet of office space and shopping centers and tens of thousands of apartments and trailer-park spaces for mobile homes. During the early 1980s, the partners sold a number of buildings in the booming Southwest and invested in Rust Belt cities like Buffalo and Chicago.

His approach, Zell concedes, doesn't call for the sort of creativity that's involved in building a business.² Contrarian speculators don't innovate much; the entrepreneur merely anticipates that the confusion or panic that has depressed prices will pass. Nor does successful execution require much managerial capacity. Organizational development, engineering, or marketing abilities add little value when an entrepreneur buys assets at a low price, expecting to sell them at a high price. Rather, good execution requires the ability to move quickly, negotiate astutely, and raise funds under favorable terms.

3. Basis of Competition: Proprietary Assets Versus Hustle. In some industries, such as pharmaceuticals, luxury hotels, and consumer goods, a company's profitability depends significantly on the assets it owns or controls—patents, location, or brands, for example. Good management practices like listening to customers, maintaining quality, and paying attention to costs, which can improve the profits of a going business, cannot propel a start-up over such structural barriers. Here a creative new technology, product, or strategy is a must.

Companies in fragmented service industries, such as investment management, investment banking, head hunting, or consulting cannot establish proprietary advantages easily but can nonetheless enjoy high profits by providing exceptional service tailored to client demands. Start-ups in those fields rely mainly on their hustle.³ Successful entrepreneurs depend on personal selling skills, contacts, their reputations for expertise, and their abili-

Microsoft's Bill Gates built a multibillion-dollar business without a breakthrough product.

ty to convince clients of the value of the services rendered. They also have the capacity for institution building—skills such as recruiting and motivating stellar professionals and articulating and reinforcing company values. Where there are few natural economies of scale, an entrepreneur cannot create a going concern out of a one-man-band or ad hoc ensemble without a lot of expertise in organizational development.

Marvin Bower, who cofounded McKinsey & Company in 1939, created a premier management consulting firm through the relentless execution of a simple idea: providing high-quality business advice to the top managers of large companies. Bower was very skilled in developing and serving his clients and was dogged in building organizational capabilities. He preached constantly the virtues of putting clients' interests first. Under his leadership, McKinsey started recruiting from top business schools, adopted an up-or-out policy to eliminate employees who didn't make the mark, declined studies that didn't fit the firm's mission of serving top management, and opened international offices to better serve chosen clientele. Bower didn't dictate policy, however, and had the patience to work on bringing partners around to his point of view. Also, he was willing to sell his stock at book value so that the equity of the firm was shared widely.⁴

Gauging Attractiveness

Entrepreneurs should also screen potential ventures for their attractiveness—their risks and rewards—compared to other opportunities. Several

less likely to face a cash crunch because of factors such as technical delays, cost overruns, and slow buildup of sales.

Other criteria reflect the typical entrepreneur's inability to undertake multiple projects: an attrac-

McKinsey & Company grew out of a simple idea: high-quality advice for top managers.

tive venture should provide a substantial enough reward to compensate the entrepreneur's exclusive commitment to it. Shut-down costs should be low: the payback should be quick, or failure soon recognized so that the venture can be terminated without a significant loss of time, money, or reputation. And the entrepreneur should have the option to cash in, for example, by selling all or part of the equity. An entrepreneur locked into an illiquid business cannot easily pursue other opportunities and risks fatigue and burnout.

These criteria cannot be applied mechanically like, say, a textbook rule of backing all projects with positive net present value (NPV). Ventures

that shine by one measure are often questionable by another. For example, a successful biotech venture whose patents provide sustainable advantages can be taken public more easily than an advertising agency. But biotech entrepreneurs need to raise significant capital and may be locked into a venture whose success can't be ascertained for many years.

Ventures must also fit what the individual entrepreneur values and wants to do. Surviving

An attractive venture should provide a substantial enough reward to compensate the entrepreneur's exclusive commitment to it.



factors should be considered. Capital requirements, for example, matter to the entrepreneur who lacks easy access to financial markets. An unexpected need for cash because, say, one large customer is unable to make a timely payment may shut down a venture or force a fire sale of the founder's equity. Therefore, entrepreneurs should favor ventures that aren't capital intensive and have the profit margins to sustain rapid growth with internally generated funds. In a similar fashion, entrepreneurs should look for a high margin for error, ventures with simple operations and low fixed costs that are

the inevitable disappointments and near disasters one encounters on the rough road to success requires a passion for the chosen business. Entrepreneurs should evaluate a potential new venture against what they're looking for and the sacrifices they're willing to make. Do they want to make a fortune, or will a small profit be sufficient? Do they seek public recognition? Is the stimulation of working with exciting technologies, customers, or colleagues important to them? Are they prepared to devote their lives to a business, or do they want to cash out quickly? Can they tolerate working in

an industry that has questionable ethical standards? Or an industry where there is high uncertainty? What financial and career risks are they prepared to take and for how long?

These deeply personal preferences determine the types of ventures that will enthuse and fortify an entrepreneur. For example, ambitious undertakings like Federal Express fit people who are ready to win or lose on a grand scale. Success can create dynastic fortunes and turn the entrepreneur into a near-cult figure. But the risks also are substantial. Visionary schemes may fail for any number of reasons: the product is flawed, cannot be made or distributed cost-effectively, serves no compelling need, or requires customers to incur unacceptable switching costs. Worse, the failure may not be apparent for several years, locking the entrepreneur into an extended period of frustrating endeavor. Even businesses that succeed may not be financially rewarding for their founders, especially if they encounter delays en route. Investors may dump the visionary founders or demand a high share of the equity for additional financing. The entrepreneur must therefore anticipate recurring disappointments and a high probability that years of toil may come to naught. Unless entrepreneurs have a burning desire to change the world, they should not undertake revolutionary ventures.

Surprisingly, small endeavors often hold more financial promise than large ones. Often the founders can keep a larger share of the profits because they don't dilute their equity interest through multiple rounds of financings. But entrepreneurs must be willing to prosper in a backwater; dominating a neglected market segment is sometimes more profitable than intellectually stimulating or glamorous. Niche enterprises can also enter the "land of the living dead" because their market is too small for the business to thrive but the entrepreneur has invested too much effort to be willing to quit.

Speculators like Zell, who don't build a company or introduce an innovation to the world, can take pleasure from showing up the crowd. Their financial risks and returns depend on the terms of the deal, the capital at risk, the conditions and amount of borrowing, and, of course, the price of the asset acquired. Risks are generally not staged; the entrepreneur is fully exposed when the asset is acquired. Liquidity or exit options often turn on the success of the speculation: if, as hoped, prices rise, the speculator can expect many buyers for the asset owned, but if prices

decline or stay depressed, market liquidity for the asset will be generally poor. All things considered, such ventures appeal most to entrepreneurs who enjoy making deals and rolling the dice.

A new company that is based on hustle in, say, consulting or advertising can provide the satisfaction of working with talented colleagues in a dynamic and competitive market. Capital requirements are low, and investments can be staged as the business grows. Entrepreneurs can therefore avoid significant personal risk and meddling by outside investors. But although such businesses can provide attractive current income, great wealth in those situations is elusive: hustle businesses, which lack a sustainable franchise, cannot be easily sold or taken public at a high multiple of earnings. The entrepreneur must therefore savor the venture enough to make a long-term career of it rather than enjoy the fruits of a quick harvest.

Parsimonious Planning and Analysis

To conserve time and money, successful entrepreneurs minimize the resources they devote to researching their ideas. Unlike the corporate world, where foil mastery and completed staff work can make a career, the entrepreneur only does as much planning and analysis as seems useful and makes subjective judgment calls when necessary.

As Harvard's Michael Porter has pointed out, a start-up faces competition not only from rivals offering the same goods but also potentially from substitutes, suppliers, buyers, and other new entrants. A start-up even competes with companies outside its industry for employees and capital. A complete analysis, therefore, would cover many industry par-

**Surviving the inevitable
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ticipants and probe internal core competencies and weaknesses. But the astute entrepreneur isn't interested in completeness. He or she understands that returns from additional analysis diminish rapidly and avoids using spreadsheet software to churn out detailed but not particularly insightful analyses of a project's break-even point, capital requirements, payback period, or NPV.

In setting their analytical priorities, entrepreneurs must recognize that some critical uncertainties cannot be resolved through more research. For example, focus groups and surveys often have little value in predicting demand for products that are truly novel. At first, consumers had dismissed the need for copiers, for instance, and told researchers they were satisfied with using carbon paper. With issues like this, entrepreneurs have to resist

Standard checklists or one-size-fits-all approaches don't work. The appropriate analytical priorities vary for each venture.

the temptation of endless investigation and trust their judgment.

The parsimonious analyst should also avoid research that he or she can't act on. For example, understanding broad market trends and the strategies of the industry leaders is unlikely to affect what a start-up in a hustle business like advertising does and therefore isn't worth bothering with. Entrepreneurs should concentrate instead on issues that they can reasonably expect to resolve through analysis and that determine whether and how they will proceed. Resolving a few big questions – understanding what things *must* go right and anticipating the venture-destroying pitfalls, for instance – is more important than investigating many nice-to-know matters.

Standard checklists or one-size-fits-all approaches don't work for entrepreneurs. The appropriate analytical budget and the issues that are most worthy of research and analysis depend on the characteristics of each venture.

Ambitious endeavors like Federal Express, for example, require significant capital and must be better researched and documented than ventures that can be self-financed. Professional investors usually ask for a written business plan because it provides clues about the entrepreneur's seriousness of purpose, concern for investors, and competence. So entrepreneurs must write a detailed plan even if they are skeptical about its relationship to the subsequent outcomes.

Revenues are notoriously difficult to predict. At best, entrepreneurs may satisfy themselves that their novel product or service delivers considerably greater value than current offerings do; how quick-

ly the product catches on is a blind guess. Leverage may be obtained, however, from analyzing how customers might buy and use the product or service. Understanding the purchase process can help identify the right decision makers for the new offering. With Federal Express, for instance, it was important to go beyond the mailroom managers who traditionally bought delivery services. Understanding how products are used can also help by revealing obstacles that must be overcome before consumers can benefit from a new offering.

Visionary entrepreneurs must guard against making competitors rich from their work. Many concepts are difficult to prove but, once proven, easy to imitate. Unless the pioneer is protected by sustainable barriers to entry, the benefits of a hard-fought revolution can become a public good rather than a boon to the innovator. Sun Microsystems and Apple, for example, won big from pathbreaking innovations that had been developed at Xerox's Palo Alto Research Center.

Entrepreneurs who hope to secure a niche face different problems: they often fail because the costs of serving a specialized segment exceed the benefits to customers. Entrepreneurs should therefore analyze carefully the incremental costs of serving a niche and take into account their lack of scale and the difficulty of marketing to a small, diffused segment. And especially if the cost disadvantage is significant, entrepreneurs should determine whether their offering provides a significant performance benefit. Whereas established companies can vie for share through line extensions or marginal tailoring of their products and services, the start-up must really wow its target customers. A marginally tastier cereal won't knock Kellogg's Cornflakes off supermarket shelves.

Inadequate payoffs also pose a risk for ventures that address small markets. For example, a niche venture that can't support a direct sales force may not generate enough commissions to attract an independent broker or manufacturers' rep. Entrepreneurs will eventually lose interest too if the rewards aren't commensurate with their efforts. Therefore, the entrepreneur should make sure that everyone who contributes can expect a high, quick, or sustainable return even if the venture's total profits are small.

Entrepreneurs who seek to leverage factors like changing technologies, customer preferences, or regulations should avoid extensive analysis. Research conducted under conditions of such turbu-

lence isn't reliable, and the importance of a quick response precludes spending the time to make sure every detail is covered.

The entrepreneur has to live with critical uncertainties, such as the relative competence of rivals or the preferences of strategic customers, which are not easy to analyze. Who could have forecast, for example, that Sun Microsystems's four 27-year-old founders, who had virtually no business or industry experience, would beat more than a dozen start-ups, including Apollo, a textbook venture launched by industry superstars? Or that IBM would turn to Microsoft for an operating system, gain dominance for its hardware, and go on to dethrone Digital Research's entrenched CP/M operating system? Entering a race requires faith in one's ability to finish ahead of whoever else might happen to play.

Analyzing whether or not the rewards for winning are commensurate with the risks, however, can be a more feasible and worthwhile exercise. In some technology races, success is predictably short-lived. In the disk-drive industry, for example, companies that succeed with one generation of products are often leap-frogged when the next generation arrives. In engineering workstations, however, Sun enjoyed long-term gains from its early success because it established a durable architectural standard. If success is unlikely to be sustained, entrepreneurs should have a plan for making a good return while it lasts.

Ventures in fast-changing markets are more likely to fold because they can't design, produce, or sell a timely, cost-effective product that works than because they pursued a poor strategy. Successful entrepreneurs, therefore, usually devote more attention to operational analysis and planning than strategic planning. Sun's business plan, one founder recalls, was mainly an operating plan, containing specific timetables for product development, opening sales and service offices, and hiring engineers.

For speculators like Zell who seek to purchase assets at depressed prices, two sets of analysis are crucial. One relates to the market dynamics for the asset being acquired or, more specifically, why the prices of the asset may be expected to rise. Entrepreneurs should try to determine whether prices are temporarily low (due to, say, an irrational panic or a temporary surge in supply), in secular decline because of permanent changes in supply or de-

mand, or merely correcting after an irrational prior surge. Also important to analyze is the entrepreneur's ability to hold or carry the asset until it can be sold at a profit because it is difficult to predict when temporarily depressed prices will return to normal. Carrying capacity depends on the extent of borrowing used to purchase the asset, the conditions under which financing may be revoked, and the income produced by the asset. Rental properties or a producing well that provides ongoing income, for example, can be carried more easily than raw land or drilling rights. For certain kinds of assets, mines and urban rental properties, for example, the entrepreneur should also consider the risks of expropriation (through, for example, rent control) and windfall taxation.

In ventures based on hustle rather than proprietary advantages, a detailed analysis of competitors and industry structure is rarely of much value. The ability to seize short-lived opportunities and execute them brilliantly is of far more importance than a long-term competitive strategy. Analysis of specific clients and relationships dominates general market surveys. Partnership agreements, terms for offering equity to later employees, performance measurement criteria, and bonus plans are important determinants of company success and are best thought through before launch rather than hastily improvised later on. And although projections of

Start-ups with powerful competitors must wow their customers. A marginally tastier cereal won't knock Kellogg's Cornflakes off supermarket shelves.



long-term cash flows are not meaningful, back-of-the-envelope, short-term cash forecasts and analyses of breakevens can keep the entrepreneur out of trouble. Overall, though, the analytical preparation required for such ventures is modest.

Integrating Action and Analysis

Standard operating procedure in large corporations usually makes a clear distinction between analysis and execution. In contemplating a new

venture, managers in established companies face issues about its fit with ongoing activities: Does the proposed venture leverage corporate strengths? Will the resources and attention it requires reduce the company's ability to build customer loyalty and improve quality in core markets? These concerns dictate a deliberate, "trustee" approach: before they can launch a venture, managers must investigate an opportunity extensively, seek the counsel of people higher up, submit a formal plan, respond to criticisms by bosses and corporate staff, and secure a headcount and capital allocation.⁵

Entrepreneurs who start with a clean slate, however, don't have to know all the answers before they act. In fact, they often can't easily separate action and analysis. The attractiveness of a new restaurant, for example, may depend on the terms of the lease; low rents can change the venture from a mediocre proposition into a money machine. But an entrepreneur's ability to negotiate a good lease cannot be easily determined from a general prior analysis; he or she must enter into a serious negotiation with a specific landlord for a specific property.

Acting before an opportunity is fully analyzed has many benefits. Doing something concrete builds confidence in oneself and in others. Key employees and investors will often follow the individual who has committed to action, for instance, by quitting a job, incorporating, or signing a lease. By taking a personal risk, the entrepreneur convinces other people that the venture *will* proceed, and they may believe that if they don't sign up, they could be left behind.

Early action can generate more robust, better informed strategies too. Extensive surveys and focus-group research about a concept can produce misleading evidence: slippage can arise between research and reality because the potential customers interviewed are not representative of the market, their enthusiasm for the concept wanes when they see the actual product, or they lack the authority to sign purchase orders. More robust



An entrepreneur's willingness to act on sketchy plans and inconclusive data is often sustained by an almost arrogant self-confidence.

strategies may be developed by first building a working prototype and asking customers to use it before conducting extensive market research.

The ability of individual entrepreneurs to execute quickly will naturally vary. Trial and error is less feasible with large-scale, capital-intensive ventures like Orbital Sciences, which had to raise over \$50 million to build rockets for NASA, than with a consulting firm start-up. Nevertheless, some characteristics are common to an approach that integrates action and analysis:

□ *Handling Analytical Tasks in Stages.* Rather than resolve all issues at once, the entrepreneur does only enough research to justify the next action or investment. For example, an individual who has developed a new medical technology may first obtain crude estimates of market demand to determine whether it's worth seeing a patent lawyer. If the estimates and lawyer are encouraging, the individual may do more analysis to investigate the wisdom of spending money to obtain a patent. Several more iterations of analysis and action will follow before the entrepreneur

prepares and circulates a formal business plan to venture capitalists.

□ *Plugging Holes Quickly.* As soon as any problems or risks show up, the entrepreneur begins looking for solutions. For example, suppose that an entrepreneur sees it will be difficult to raise capital. Rather than kill the idea, he or she thinks creatively about solving the problem. Perhaps the investment can be reduced by modifying technology to use more standard equipment that can be rented instead of bought. Or under the right terms, a customer might underwrite the risk by providing a large initial order. Or expectations and goals for growth might be scaled down, and a niche market could be tackled first. Except with obviously unviable ideas that can be ruled out through elementary logic, the purpose of analysis is not to find fault with new ventures or find reasons for abandoning them. Analysis is an exercise in what to do next more than what not to do.

□ *Evangelical Investigation.* Entrepreneurs often blur the line between research and selling. As one founder recalls, "My market research consisted of taking a prototype to a trade show and seeing if I could write orders." Software industry "beta sites" provide another example of simultaneous research and selling; customers actually pay to help vendors test early versions of their software and will often place larger orders if they are satisfied with the product.

From the beginning, entrepreneurs don't just seek opinions and information, they also look for commitment from other people. Entrepreneurs treat everyone whom they talk to as a potential customer, investor, employee, or supplier, or at least as

Entrepreneurs must be smart enough to recognize mistakes and change strategies.

a possible source of leads down the road. Even if they don't actually ask for an order, they take the time to build enough interest and rapport so they can come back later. This simultaneous listening and selling approach may not produce truly objective market research and statistically significant results. But the resource-constrained entrepreneur doesn't have much choice in the matter. Besides, in the initial stages, the deep knowledge and support of a few is often more valuable than broad, impersonal data.

□ *Smart Arrogance.* An entrepreneur's willingness to act on sketchy plans and inconclusive data is often sustained by an almost arrogant self-confidence. One successful high-tech entrepreneur likens his kind to "gamblers in a casino who know they are good at craps and are therefore likely to win. They believe: 'I'm smarter, more creative, and harder working than most people. With my unique and rare skills, I'm doing investors a favor by taking their money.'" Moreover, the entrepreneur's arrogance must stand the test of adversity. Entrepreneurs must have great confidence in their talent and ideas to persevere as customers stay away in droves, the product doesn't work, or the business runs out of cash.

But entrepreneurs who believe they are more capable or venturesome than others must also have the smarts to recognize their mistakes and to change their strategies as events unfold. Successful ventures don't always proceed in the direction on

which they initially set out. A significant proportion develop entirely new markets, products, and sources of competitive advantage. Therefore, although perseverance and tenacity are valuable entrepreneurial traits, they must be complemented with flexibility and a willingness to learn. If prospects who were expected to place orders don't, the entrepreneur should consider reworking the concept. Similarly, the entrepreneur should also be prepared to exploit opportunities that didn't figure in the initial plan.

The evolution of Silton-Bookman Systems illustrates the importance of keeping an open mind. The venture's original plan was to sell general-purpose, PC-based software for human resource development. But established competitors who already sold similar software on mainframes were beginning to develop products for PCs. So the company adopted a niche strategy and developed a training registration product. And although the founders had initially targeted small companies that couldn't afford mainframe solutions, their first customer was someone from IBM who happened to respond to an ad. Thereafter, Silton-Bookman concentrated its efforts on large companies, where they had considerable success. "The world gives you lots and lots of feedback," co-founder Phil Bookman observes. "The challenge is to take advantage of the feedback you get."

The apparently sketchy planning and haphazard evolution of many successful ventures like Silton-Bookman doesn't mean that entrepreneurs should follow a ready-fire-aim approach. Despite appearances, astute entrepreneurs do analyze and strategize extensively. They realize, however, that businesses cannot be launched like space shuttles, with every detail of the mission planned in advance. Initial analyses only provide plausible hypotheses, which must be tested and modified. Entrepreneurs should play with and explore ideas, letting their strategies evolve through a seamless process of guesswork, analysis, and action.

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